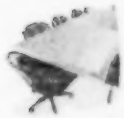

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OSFI BSIF

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FROM THE OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS CANADA (OSFI)

OSFI Welcomes Gaetano Geretto as New Senior Director

OSFI is pleased to announce that as of December 1st, 2008, Gaetano Geretto has joined OSFI as Senior Director of the Life Conglomerates Group (LCG). His appointment reflects a decision by OSFI to ensure additional focus on banks and life companies by having each group led by a senior director.

In the four year prior to joining OSFI, Gaetano was president of Pelecanus Strategic Advisory Services, a consulting firm providing strategy development and stakeholder and risk management services to senior leadership teams in the life insurance/reinsurance sectors in Canada, the United States and the European Union. Previously, he held executive and senior management positions in leading insurance companies, including Gerling Global Life, Sun Life, Transamerica and Prudential, in the areas of life insurance/reinsurance, group life and health insurance, pensions, marketing and actuarial valuations.

Gaetano, a graduate of McGill University, in Montréal, is a Fellow of both the Canadian Institute of Actuaries and the Society of Actuaries. He has played an active role in professional organizations such as the Canadian Life and Health Insurance Association and the American Council of Life Insurers.

Appropriate Capital in a Turbulent Market

The following text is an excerpt from Superintendent Julie Dickson's January 8th address to the 2009 RBC Capital Markets CEOs Conference.

The main issue, now, is the economy. The current economic situation will challenge all financial institutions. The economic downturn is the second wave to hit the system since August 2007. Canadian banks handled the first wave -- global financial market turmoil -- relatively well compared to many of their global counterparts. The second wave -- a serious economic downturn -- is hitting while financial market turmoil remains ongoing.

The second wave will affect both capital levels and profits at banks. The extent and severity of the hit is hard to predict, but the Canadian banking system is probably better positioned than most other systems to deal with this second wave. It is very well capitalized, and has avoided the need for government injections of capital -- unlike most advanced systems in the world -- and has been able to tap the capital markets for additional capital.

Capital - What Level is Enough?

Aside from the procyclicality debate, there is also a debate about what level of capital is enough, whether regulators have much of a role today in setting capital expectations or whether it is the markets that are deciding capital levels.

It was a unique experience for OSFI to put out a statement on December 22, 2008, saying that we had not pushed for capital increases across the board in the banking industry, and that in our view, it was the market that was pushing. How did we get to this point?

Regulators like OSFI tend to set minimum levels of capital as thresholds that must be met in order for us to allow an institution to continue to take money from the public. OSFI also sets a higher target level, a level at which other types of regulatory intervention would likely take place, given that capital is the first line of defense when something goes wrong. Solid buffers are key to safety and soundness, as a lot can go wrong in the financial sector. (cont'd page 2)

Superintendent Remarks to RBC Conference — cont'd from page 1

Institutions hold capital above the OSFI target level in order to avoid hitting the target. They also operate with higher capital levels based on their unique needs -- banks know their business, their balance sheet, and their risks -- and the capital should reflect that assessment. We have been pushing banks, as part of Basel 2, to really focus on this.

Institutions also hold capital above regulatory targets in order to retain high ratings from ratings agencies (with respect to rating agencies, capital is but one element in the rating, but generally the higher the capital the higher the rating). Lastly, institutions also pay close attention to their stock price and that is affected by the market's view of capital adequacy and profitability.

OSFI's view of whether an institution is well capitalized is based on the answers to a number of questions. The size of the cushion should depend on: what are the cushions made of (amount of common shares which has more loss absorbing capacity); what kind of losses might hit the cushion; whether the cushion is based on through-the-cycle estimates (so that required capital stays relatively constant); expertise of the bank and quality of risk management in general at the institution and for significant business lines; leverage; and the outlook for the economy (both global and domestic), especially in key markets in which an institution operates.

While the market is also expressing a view on the size of the cushion, I think it is important to keep in mind that capital cushions are meant to fall when needed --otherwise they are not cushions, they are more like cement. As well, as suggested above, determining capital adequacy requires an in-depth assessment of many factors unique to a financial institution and involves more than just comparing Tier 1 ratios across global banks.

OSFI's view on capital is not related to what levels are needed to make stock prices perform better, or to what might be needed for an institution to get a high rating from a rating agency. Also, capital is but one of the considerations in determining OSFI's intervention rating for a financial institution. A lot of other factors also come into play.

Finally in this stage of the cycle, the downturn, it is also important to carefully assess the situation and not over-react or under-react History tells us that changes in risk associated with the economic cycle tend to be incorrectly assessed. In particular risk is often underestimated in booms (bad loans are made in good times), and overestimated in recessions (when loans might be cut back). History also tells us that markets can overshoot. At the end of the day, these are tough issues but I think we need to look at them in a balanced fashion to try to avoid undershooting or overshooting.

To view the complete text of Superintendent Julie Dickson's remarks, visit the OSFI Web site at: www.osfi-bsif.gc.ca

OSFI Position on Capital Levels

Recent media reports regarding the Office of the Superintendent of Financial Institutions' (OSFI) position on capital ratio levels may have led to some confusion. On December 22, 2008, OSFI provided the following information to the media:

OSFI's views on capital were outlined in a speech given by Superintendent Julie Dickson on November 13, 2008, and those views have not changed. In that speech, the Superintendent made a number of points, among them, that Canadian banks remain well capitalized. It noted that common equity ratios of the large banks are particularly high, and that markets ought to consider this in their views about capital adequacy. This point was made because markets were demanding that Canadian banks increase capital, possibly based on a simple comparison of Tier 1 levels across global banks, even though many global banks have had capital injections from governments. Further, it was noted that banks should not engage in share buy-backs without first clearing it with OSFI, as capital needed to be managed conservatively. Managing capital conservatively does not mean increasing capital.

OSFI has discussed global market developments both with banks and international regulators, as a similar phenomenon of markets taking a view on capital and driving up capital levels, is being observed globally. At the same time, to the extent banks have met market expectations regarding capital, this makes Canadian banks well-positioned to continue to lend. As well, OSFI has increased flexibility within its rules by increasing the preferred share limit to 40 per cent from 30 per cent, which reduces the cost of capital for financial institutions, and may further support lending.

In short, OSFI has not pushed for higher capital ratios across the board, and OSFI agrees that capital is a cushion that should be available to be drawn down when faced with unexpected losses.

To view the complete posting, visit the OSFI Web site at: www.osfi-bsif.gc.ca

Letter from the Superintendent to Pension Plan Administrators on the Implications of Market Conditions on Defined Benefit Pension Plans

The recent market downturn and ongoing market volatility are strong reminders of the importance of being prepared for a wide range of potential shocks or adverse events. In PBSA Update 29 (June 2008), we noted the potential for changes in financial markets and economic conditions to adversely impact pension plans. We also encouraged administrators to understand their risk tolerances and to undertake scenario testing in order to help identify potential exposures and to take initiatives to manage risks prudently to safeguard pension benefits.

As part of its risk-based approach to supervision, OSFI also considers the effects of a range of market conditions on the federal private pension sector. One tool we use is the Estimated Solvency Ratio (ESR) testing that we conduct every six months, which showed at June 30, 2008 deterioration in the average solvency ratio of federal pension plans to 0.98. Since then, financial markets have experienced sharp declines and significant turbulence. If current market conditions continue, we can expect asset values for many plans to be severely eroded at year-end.

In this environment, it is essential that plan sponsors and administrators carefully consider the implications of the market downturn on their pension plans. Although market values used in solvency valuations will only be known at a pension plan's year-end, particular issues for plans to consider now include:

- Estimated 2009 contribution requirements – the government's recently announced solvency funding relief measures would permit longer amortization of solvency deficiencies, but plans should recognize that their contribution requirements may still be materially higher than in 2008.
- Any negotiated contribution defined benefit (NCDB) plans that expect their negotiated contribution levels will not be sufficient to meet the minimum funding requirements for 2009 should develop, and provide to OSFI as soon as possible, an action plan to address such a situation.
- Any pension fund liquidity pressures – for example, payments of benefits may necessitate sales of fund assets at possibly depressed values.
- For sponsors that have been taking a contribution holiday, whether continuation of the contribution holiday remains appropriate in light of the plan's projected solvency position.

As noted above, pension plan sponsors and administrators need to be prepared for the effects of the current market downturn. They should also continue to consider a range of longer-term scenarios, including the possibility of protracted market weakness, and think about possible responses that are consistent with their risk tolerance. We strongly encourage plan administrators and sponsors to use regular scenario testing as a risk management tool.

Please do not hesitate to contact your OSFI relationship manager to discuss your particular situation.

To view the complete letter, visit the OSFI Web site at: www.osfi-bsif.gc.ca

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Guideline B-8 – Deterring and Detecting Money Laundering and Terrorist Financing

In December 2008, OSFI posted a revised guideline which came into effect immediately. It sets out OSFI's expectations for federally regulated financial institutions (FRFIs) (except for property and casualty insurance companies, cooperative credit associations and fraternal benefit associations) with respect to anti-money laundering (AML) and anti-terrorist financing (ATF) risk management and compliance controls.

The accompanying Guideline Impact Analysis Statement sets out the background and reasons for revising this Guideline.

As noted, it is essential for FRFIs to have strong AML/ATF controls in place in order to reduce the potentially serious risks faced by FRFIs as a result of exposure to money laundering and terrorist financing activities. OSFI believes this Guideline will assist FRFIs in mitigating these risks through strengthening their AML/ATF programs.

OSFI would like to express sincere thanks to industry associations for their valuable input to the preparation of this Guideline. Questions concerning the implementation of the Guideline should be addressed to OSFI's Compliance Division.

To view the guideline, visit the OSFI Web site at: www.osfi-bsif.gc.ca

Advisories on Innovative Tier-1 Instruments

OSFI has revised two Advisories related to innovative Tier 1 capital.

The *Innovative Tier 1 Instruments* advisory is the final version, reflecting a few technical modifications from the Draft Advisory Innovative Tier 1 Instruments issued in June 2008. This amended version includes changes to Principle #3(b)2) of the appendix Principles Governing Inclusion of Innovative Instruments in Tier 1 Capital related to the preferred shares issued upon automatic conversion.

It also provides further clarification on the preferred shares issued in a cash coupon deferral period and requires that the inter-company instrument have a maturity of 99 years.

The second Advisory, entitled *Innovative Tier 1 and Other Capital Clarifications – Revised Version*, is an update to the June 2007 version to reflect that trust preferred securities issued by an intermediate holding company are eligible for innovative Tier 1 capital treatment in the calculation of federally regulated entities' consolidated regulatory capital. These instruments previously qualified as Tier 2B capital.

These Advisories replace the June 2008 draft Advisory and June 2007 final Advisory respectively and are effective immediately. Questions concerning either Advisory should be addressed to Paul Melaschenko, Capital Division, by facsimile at (613) 991-6822 or by e-mail at paul.melaschenko@osfi-bsif.gc.ca.

To view the advisories, visit the OSFI Web site at: www.osfi-bsif.gc.ca

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What's New Online (www.osfi-bsif.gc.ca)

Revised MCCSR guideline and advisories

In December 2008, the Office of the Superintendent of Financial Institutions issued a revised version of its Minimum Continuing Capital and Surplus Requirements Guideline and three related advisories.

A fourth advisory was also issued, allowing all Federally Regulated Entities (FREs) to calculate the capital impact of certain mark-to-market accounting changes on an after-tax basis to reflect proposed tax legislation.

The following were posted on the OSFI Web site:

- MCCSR - Guideline, revised December 2008 (in effect at the beginning of the first fiscal quarter of 2009)
- Supplementary Information for Life Insurance Companies that Determine Segregated Fund Guarantee Capital Requirements Using an Approved Model
- Alternative Method for Life Insurance Companies that Determine the Segregated Fund Guarantee Capital Requirement Using Prescribed Factors
- Recognition of Hedge Contracts in the Determination of the Segregated Fund Guarantee Capital Requirement for Life Insurance Companies
- Temporary Adjustments to Regulatory Financial Statements to Take into Account Proposed Tax Changes on Fair Value Accounting For Financial Instruments

To view the complete documents, visit the OSFI Web site at: www.osfi-bsif.gc.ca

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The OSFI *Pillar*

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